



STATE OF ARKANSAS  
**Department of Finance  
and Administration**

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November 20, 2001

The Honorable Mike Huckabee, Governor  
The Honorable Members of the Arkansas General Assembly  
The Citizens of Arkansas

It is my pleasure to transmit to you the Comprehensive Annual Financial Report of the State of Arkansas (the State) for the fiscal year ended June 30, 2001. The report has been prepared by the Department of Finance and Administration. Responsibility for both the accuracy of data and the completeness and fairness of the presentation, including all disclosures, rests with the Department of Finance and Administration. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to present fairly the financial position of the various funds and account groups of the State. All disclosures necessary to enable the reader to gain an understanding of the State's financial activities have been included.

The report is presented in three sections. The introductory section includes this transmittal letter with narrative commentary on matters of interest to the reader and the State's organizational chart; the financial section includes the independent auditors' report, general purpose financial statements, notes to the financial statements, required supplementary information, combining financial statements by fund type, schedules for account groups and other schedules; the statistical section includes selected financial, economic, and demographic data for the State on a multi-year basis.

All agencies, accounts, departments, boards and commissions that represent the State's reporting entity are included in this report. The criteria used in determining the State's reporting entity are fully discussed in Note 1. The State provides a full range of services including: education, health and human services, transportation, public safety, conservation of natural resources, economic development and regulation of businesses and professionals.

### **ECONOMIC CONDITION AND OUTLOOK**

**Real Output.** In FY 2001, real output (1996\$) of final goods and services, is estimated at \$65,950 million, an increase of 2.8 percent or \$1,810 million over FY 2000. Following September 11, 2001, FY 2002 real output is now estimated at \$66,641 million, an increase of 1.05 percent, or \$691 million.

**State Personal Income.** Personal income consists of wages and salaries, dividends, interest, rent and transfer payments such as social security and other retirement incomes. Personal income does not include realized capital gains from the sale of assets.

Personal income is measured in current dollars and reached a total of \$60,612 million in FY 2001. This represented an increase of \$2,632 million or 4.5 percent over FY 2000.

Following September 11, 2001, state personal income for FY 2002 is estimated at \$61,933, an increase of \$1,321 million or 2.2 percent over FY 2001.

**FY 2001 Net Available General Revenues.** Actual net available general revenues distributed totaled \$3,258.98 million. This amount is \$83.4 million or 2.6 percent above the net available distribution of FY 2000.

**Employment.** In FY 2001, non-agricultural payroll employment expanded by 12,100 jobs or 1.0 percent over FY 2000. The level of employment set a record of 1,165,400 jobs. The revised forecast for the current FY 2002 expects a decline of 9,000 payroll jobs or an 0.8 percent decline from FY 2001.

Manufacturing employment declined in FY 2001 by 4,960 jobs or 2.0 percent. The revised manufacturing employment estimate for FY 2002 is a further decline of 16,750 jobs or 6.8 percent. The estimated level of manufacturing employment for FY 2002 is 230,670 jobs.

**FY 2002 Net Available General Revenues.** Net available general revenues are now estimated at \$3,249.7 million. This amount is \$9.3 million or 0.3 percent below actual collections of FY 2001. Compared to the March 29, 2001 forecast, the new forecast reduces net available revenues by \$142.0 million or 4.2 percent. The reduction eliminates \$129.2 million or all of Category B, and \$12.8 million or 0.4% of Category A under the Revenue Stabilization Law. This means 99.6% of Category A is funded effective November 15, 2001.

**U.S. and Arkansas Real Growth.** The national forecasting firm, Data Resources Incorporated-Wharton Econometric Forecasting Associates, expects a shallow recession with real growth in output of goods and services expected to resume in the second quarter (April - June) of CY 2002. But for all of FY 2002, real growth is estimated at 0.05%. In FY 2003, U.S. real growth is estimated at 3.6 percent. Arkansas will follow a similar path.

Consumer confidence, lower interest rates, increased federal spending, no further terrorist attacks, and military success are the keys to the depth and length of this recession. If these key assumptions are met, then the U.S. and Arkansas recoveries will most likely be under way in FY 2003 or sooner.

## **MAJOR INITIATIVES**

### **Tax Reform and Tax Relief**

On November 7, 2000, Arkansas voters approved an amendment to the State Constitution that provides a property tax credit of up to \$300 for homeowners. Act 1492 of 1999 stipulated that if voters approved Amendment 2, the state sales tax would increase ½ cent on January 1, 2000, to fund the Amendment. Actions of the 82<sup>nd</sup> General Assembly and the Governor resulted in significant accomplishments in tax reform and tax relief. Property tax refunds were increased, a Property Taxpayers' Bill of Rights was established, a law was passed requiring a county assessor to give notice to a property owner at least 45 days before a reappraisal, as well as a host of other property tax reform measures. Act 1185 of 1999 requires each county to institute a system of regular revaluation of all real estate. The revaluation efforts will be funded by the State. Counties have the option to conduct their own revaluation programs or contract the work to private firms. In either case, counties must adhere to new standards that ensure fairness and equity. Any assessment increases resulting from the revaluation efforts will be phased in over three years.

Several measures passed and signed by the Governor provide for income tax reform and relief, in particular to encourage saving and provide relief through changes in dependent tax credits and the state income tax credit for household and dependent care. Finally, Act 1005 of 1999 excludes the first 30% of a capital gain from the state individual income tax.

### **Highways and Transportation**

Three hundred eighty miles of interstate highways in Arkansas will be rebuilt during the five-year Interstate Rehabilitation Program ("IRP") that is now underway. This is the most ambitious highway rehabilitation project ever undertaken in Arkansas, and will result in a multitude of benefits for all Arkansans and for

others who use the interstate highways. The benefits of this historic undertaking include safer travel, earlier project completion, less wear and tear on vehicles and more efficient movement of goods and services. All Arkansans will share the benefits of the program in many ways.

An example of the massive scope of the program can be seen in a comparison of the amount of work done on interstate highways prior to the IRP and the amount being undertaken as part of the program. For example:

- With the IRP, the Highway and Transportation Department will average about 125 miles of interstate reconstruction in each of the next two years compared to a rate of 15 miles re-done in years prior to 2000.
- All 284 miles of Interstate 40 were originally constructed at a cost of less than \$1 million per mile, yet current reconstruction costs will be between \$2 million and \$3 million per mile.
- It took about 20 years and \$837 million to construct the 542 miles of interstates in Arkansas, excluding Interstate 530 and the new section of Interstate 540. It will take approximately five years and \$950 million to reconstruct 69 percent of those interstate miles with the Interstate Rehabilitation Program.

By 2002, all 380 miles of construction work will be underway, with completion scheduled by 2005. The Interstate Rehabilitation Program is possible through an innovative financing concept known as Grant Anticipation Revenue Vehicles. The Arkansas State Highway Commission will be able to use future federal funds to retire \$575 million worth of bonds as passed by the Arkansas General Assembly and approved 4 to 1 by Arkansas voters in 1999. Repayment will also come from required state matching funds and the proceeds from a phased-in 4-cent-a-gallon increase in the state tax on diesel fuel.

### **Arkansas Administrative Statewide Information System**

Arkansas is the first state in the country to integrate all its accounting and budgetary functions, human resources functions and various means of communication with the public into a single innovative system. No other state has implemented or is in the process of implementing as many applications as currently planned by the State of Arkansas. The Arkansas Administrative Statewide Information System ("AASIS") standardizes, integrates and streamlines the financial and administrative functions of Arkansas State Government. It will enable performance based budgeting, activity-based costing, and provide enhanced reporting capabilities for the State's decision-makers. AASIS automates many manual functions; distributes and reduces redundant data entry; simplifies storage and processing; improves financial controls; and enhances the value and availability of information provided to State agency executives, the Governor, the Legislature, and the people of Arkansas. It employs electronic procurement solutions to achieve efficiency in interacting with business partners and reduces or eliminates paper documentation. AASIS implements a solution based on proven, state-of-the-art technologies that can migrate to technologies of tomorrow. It implements secure self-service web-enabled solutions whereby employees, retirees, and fiduciaries have direct access to necessary personnel, payroll, benefit, and retirement information, plus builds a framework to enhance the public's access to information. The AASIS system brings Arkansas state agencies together for the good of all taxpayers and employees.

### **ARTAX**

The Office of Excise Tax Administration launched a new Internet Filing System for Excise Tax reports, effective August 9, 2000. The online filing process for monthly reports benefits everyone from multi-state corporations to sole proprietors. Other types of taxes such as state income tax withholding will be available

online in the future. Two vendors are currently providing filing services over the web. The first vendor is Nationtax® Online from Birmingham, Alabama. The second vendor, *Artax*, is a product of the efforts of the Department of Finance and Administration and Information Network Arkansas. *Artax* is a filing service for Arkansas reporting only. Both providers have step-by-step online demonstrations of their services available.

There are links to both providers from the Department's Sales & Use Tax website: <http://www.state.ar.us/dfa/taxes/salestax/index.html>. Both service providers allow the taxpayer to enter sales information and then the program calculates the tax due or tax refund. This will reduce calculation errors in completing the report. Tele-file is a similar paper less program that allows Sales and Use Tax permit holders to file a monthly report of zero sales over the telephone. Tele-file receives approximately 5,000 reports per month.

## Education

Governor Mike Huckabee proposed a \$3,000 a year raise for Arkansas teachers as part of his balanced budget proposal which was approved by the Legislature. The Governor's plan increased teacher salaries \$1,000 during the first year of the new biennium, then increased teacher salaries another \$2,000 the second year of the new biennium.

The Governor proposed far reaching legislation in the area of education that was passed during the 82<sup>nd</sup> General Assembly. Understanding that a child's academic foundation must be strong and solid, Governor Mike Huckabee launched Smart Start. This comprehensive initiative focuses on improving reading and mathematics achievement for all students in grades K-4. Through this effort, the goal is to have all students performing at grade level by the end of grade 4.

Smart Start, with a budget of \$8.4 million, is one part of the Arkansas Comprehensive Testing, Assessment, and Accountability Program, a system covering pre-kindergarten through twelfth grade and incorporating the recommendations of the 1998 Excellence in Arkansas Public Education Task Force

Through advanced technology, Arkansas students excel in rural as well as urban school districts. Sixty Arkansas high schools offer Environmental and Spatial Technology ("EAST"), a nationally acclaimed program supported by a collaborative partnership involving Intergraph Corporation, several universities and the Arkansas Department of Education. In project-based lab classes, students use geographic information systems ("GIS") and computer-aided design to develop real-world applications for community projects.

Secondary vocational education is available to every public school student in the State, either at the high school or a secondary area vocational center that serves students from surrounding school districts. Career Orientation, which introduces students to different careers and to workplace expectations, is required of every student at the junior high school level as a prerequisite for all programs of study/career majors developed by the Department of Workforce Education.

Arkansas is restructuring high school vocational education to help students make a smoother transition from school to postsecondary education and/or the workplace. Career Opportunities, High Schools that Work, and Youth Apprenticeship are part of this systemic change that provides students with academically challenging courses.

Proposals passed during the 82<sup>nd</sup> General Assembly will have long lasting effects for higher education. Act 858 of 1999 raises the family income limit on the Academic Challenge Scholarship Program. This will allow more students to attend college and will encourage Arkansans to attend college in state. Act 1158 of 1999 requires the Workforce Education and Career Opportunities Board to develop a performance-based accountability system for post-secondary and technical institutions. Act 652 of 1999 establishes the Arkansas Technical Careers Loan Forgiveness Program to assist students who will fill special needs areas in the technical skill fields.



## **Economic Development**

In an increasingly competitive environment for economic development that includes nationwide competition for high paying jobs, Arkansas' economic development efforts have been retooled and refocused with remarkable results for the future of the State. Act 995 of 1999 amends the Manufacturers Investment Tax Credit Act of 1985 to expand eligibility to include businesses engaged in a variety of services. Income tax credits were passed for eligible businesses undertaking large capital investment or job-creation projects, and for companies purchasing or constructing a facility that designs, develops or produces electric vehicles or the fuel cells that power them. Another program, established by Act 448 of 1999, creates a two-year pilot program operated by the Department of Economic Development that makes participation loans in amounts from \$5,000 to \$80,000 to small business owners in the State.

## **Law Enforcement, Criminal Justice, and Juvenile Justice Reform**

Government's most basic role is to keep our communities safe. The March 1998 shootings at Westside Middle School near Jonesboro and problems with the juvenile justice system prompted the Governor to propose legislation passed by the 82<sup>nd</sup> General Assembly. Act 1192 of 1999 authorizes juvenile judges to impose adult sanctions on offenders younger than 13 if convicted of capital or first-degree murder and judged competent to stand trial. It also allows 14 and 15 year olds convicted of a violent crime to receive adult sanctions. Significant funds were provided to the Department of Human Services - Division of Youth Services to address adequate facility and equipment needs of supervising young offenders.

Act 565 of 1999 allows, at a prosecutor's request, state Crime Lab analysts to testify in court by two-way closed-circuit or satellite-transmitted television. Legislation was passed to address a plan for a statewide radio system. To add to the State's infrastructure for training law enforcement officers, Act 688 of 1999 authorizes construction of the Northwest Arkansas satellite training facility. Act 1213 of 1999 provides personnel and equipment for the Western Regional Drug Laboratory.

## **Family Issues**

The Administration had clear recommendations in the areas of adoption reform and divorce reform for consideration by the 82<sup>nd</sup> General Assembly and had great success in passing several significant laws. Compliance with the federal Adoptions and Safe Families Act was accomplished with passage of Act 401 of 1999. Act 704 of 1999 allows judges to require divorcing parents of minors to complete two hours of parenting classes or require them to take part in divorce mediation.

Act 328 of 1999 extends subsidy payments from age 18 to 21 if a child has a documented disability that prevents him from living independently. Act 517 of 1999 amends the guardianship statute to comply with the Adoption and Safe Families Act. It allows any parent who is chronically ill or near death, without surrendering parental rights, to have a standby guardian appointed by the court. Finally, Act 518 of 1999 amends the adoption code to allow foster children to be adopted by their foster parents more quickly when they have been living in the home six months or longer.

## **Health and Human Services**

Continuing the progress made in recent years, the Governor recommended passage of Act 849 of 1999, which changed the ARKids First Program from a pilot program to a permanent program. Originally passed in 1997, ARKids First provides preventive health care insurance to the children of those making up to 200% of the poverty level. There are more than 175,000 children already insured through the program. Act 1181 of 1999 established a Nursing Home Patients' Bill of Rights.

## Government Efficiency and Anti-Corruption

Significant strides were made during the 82<sup>nd</sup> General Assembly toward improvements in government efficiency and anti-corruption legislation. The Governor signed into law several acts addressing these areas. Act 1061 of 1999 authorizes the Department of Finance and Administration to implement the Career Ladder Incentive Program for state employees. This legislation is complemented by passage of Act 221 of 2001, which for the first time in the state of Arkansas provides for a performance-based budgeting and accountability system. A major project paving the way for implementation of Performance-Based Budgeting is authorization of a new statewide integrated information system.

Anti-corruption legislation was passed to protect public employees from retaliation by their employers when an employee has told the appropriate authority about a violation of the law or a waste of public money, property or manpower. Act 34 of 1999 prohibits constitutional officers, legislators and their spouses from receiving employment during and two years after their term in office. It prohibits job enhancement if the constitutional officer, legislator or spouse has a state job prior to the term in office. It also restricts constitutional officers, legislators and their spouses from entering into contracts and lease agreements or receiving grants unless the contract, lease or grant involves a competitive bid.

## FINANCIAL MANAGEMENT

The financial statements of the State are prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”), which requires that specific fund types be used on the combined balance sheet.

There are four categories of funds. The first category is the governmental fund. The general fund is used to account for all general government activities not accounted for in another fund and is the only governmental fund currently in use.

The proprietary fund is used to account for activities similar to the private sector, where the determination of net income is necessary or useful for sound financial administration. A component of the proprietary fund is the enterprise fund which provides goods and services to outside parties.

The fiduciary fund is used to account for assets held on behalf of outside parties or other funds within the government. When assets are held under the terms of a formal trust agreement, a pension trust fund or expendable trust fund is used. The term “expendable” refers to the ability of the governing agent to spend the trust principal. Agency funds generally are used to account for assets that the government holds on behalf of others as their agent.

The higher education fund presents the State supported colleges and universities in accordance with the American Institute of Certified Public Accountants Industry Audit Guide, *Audits of Colleges and Universities*, and guidance as outlined by the National Association of College and University Business Officers and Governmental Accounting Standards Board.

Under GAAP, fund balance represents the excess of assets over liabilities. Therefore, it is possible for fund balance to remain unchanged while cash balances decrease or increase. In addition, certain amounts of fund balances may be reserved or “not spendable.”

## Internal Controls

The management of the State is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the State are protected from loss, theft or misuse and that adequate accounting data is compiled to allow the preparation of the financial statements in conformity with GAAP. The internal control structure has been designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets against loss from unauthorized use or disposition, the reliability of financial records for preparing financial statements, and maintaining accountability for assets. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

## Budgetary Control

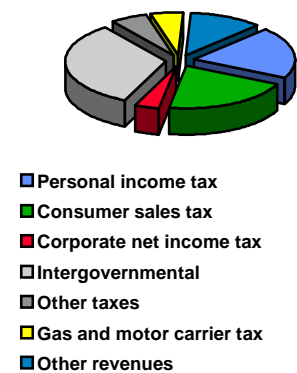
Budgetary control is maintained through legislative appropriation. Agencies submit budgetary requests to the Department of Finance and Administration. The Department of Finance and Administration compiles the executive budget on behalf of the Governor who submits it to the Legislature. The Department of Finance and Administration maintains control over the spending patterns of the State after the approval of the budget through control at the line-item level. See Note 2 (Budgetary Basis Reporting - Budgetary Process) for further discussion of budgetary controls.

## General Government Functions

Most State functions are financed through the general fund. The State's most significant sources of revenues in the general fund (GAAP basis) are taxes and intergovernmental. The State's most significant areas of expenditures from the general fund (GAAP basis) are the areas of public and higher education and health and human resources. The following charts present actual general fund (GAAP basis) revenues and expenditures for the fiscal year ended June 30, 2001 (expressed in thousands):

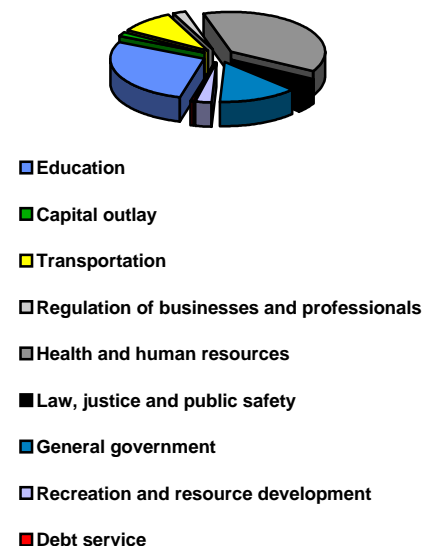
Revenues	2001	2000	Increase (Decrease) Percent
Personal income tax	\$ 1,544,526	\$ 1,454,548	6.19 %
Consumer sales tax	1,647,333	1,622,476	1.53 %
Corporate net income tax	159,700	215,562	(25.91)%
Gas and motor carrier tax	257,407	285,113	(9.72)%
Other taxes	373,688	349,969	6.78 %
Intergovernmental	2,882,725	2,613,654	10.29 %
Other revenues	<u>1,210,778</u>	<u>1,026,215</u>	<u>17.98 %</u>
Total	<u>\$ 8,076,157</u>	<u>\$ 7,567,537</u>	<u>6.72 %</u>

REVENUE BY SOURCE FOR GENERAL FUND - 2001



Expenditures	2001	2000	Increase (Decrease) Percent
Education	\$ 2,172,021	\$ 2,098,860	3.49 %
Health and human services	2,984,687	2,698,687	10.60 %
Transportation	788,416	622,061	26.74 %
Law, justice and public safety	509,428	333,211	52.88 %
Recreation and resource development	196,734	203,358	(3.26)%
General government	602,855	587,147	2.68 %
Regulation of businesses and professionals	120,189	161,703	(25.67)%
Debt service	69,841	77,244	(9.58)%
Capital outlay	<u>132,485</u>	<u>142,227</u>	<u>(6.85)%</u>
Total	<u>\$ 7,576,656</u>	<u>\$ 6,924,498</u>	<u>9.42 %</u>

EXPENDITURES FROM GENERAL FUND - 2001



Governmental revenues increased by 6.72 %, reflecting additional personal income tax revenue and consumer sales tax revenue of approximately \$90 million and \$25 million, respectively. Intergovernmental revenues increased by approximately \$269 million due primarily to increased fundings from the Department of Health Education and Welfare for the Medicaid Program and Federal Emergency Management Agency fundings for ice storm damage recovery.

Expenditures increased in fiscal year 2001 by 9.42% as the demand for governmental services rose. The principal reasons for the increase is due primarily to increases in health and human services, transportation, and law, justice and public safety.

### **Proprietary and Fiduciary Funds**

The State's enterprise operations include the Workers' Compensation Commission, the Construction Assistance Revolving Loan Fund, and Other Revolving Loan Funds. Since it is the intent of these programs to primarily recover operating costs (including depreciation) through user charges, they utilize an accrual basis of accounting with a measurement focus on the flow of economic resources.

Fiduciary funds are used to account for assets held by the State in a trustee capacity or as an agent for individuals, private organizations, other governmental units, or other funds. These include the expendable trust, pension trust and agency funds. Trust funds are established through trust agreements specifying how the funds will operate. Agency funds are custodial in nature and do not report fund balances. The trust funds include the Employment Security Division, Arkansas Judicial Retirement Plan, Arkansas Teacher Retirement Plan, Arkansas State Police Retirement Plan, Arkansas Highway Retirement Plan and Arkansas State Employees Retirement Plan. Agency funds include the State Insurance Department and Other Agencies.

### **Component Units**

The component units include the accounts of Arkansas Student Loan Authority and Arkansas Development Finance Authority. These authorities are legally separate entities that are not operating departments of the State and are managed independently with their powers generally vested in a governing board. Each authority is established for a specific purpose, such as education and economic development.

Combined operating revenues and expenses for the State's authorities amounted to approximately \$164 million and \$131 million, respectively, for fiscal year 2001. The total combined amount of retained earnings at fiscal year end was approximately \$171 million.

### **Debt Administration**

The Constitution of the State of Arkansas does not limit the amount of general obligation bonds which may be issued by the State; however, no such bonds may be issued unless approved by the voters of the State at a general election or special election held for that purpose. The total outstanding general obligation bonded indebtedness, including special obligation and other debt instruments, of the governmental fund types of the State as of June 30, 2001, was approximately \$558 million. Arkansas currently has a rating of Aa2 from Moody's Investors Service and a rating of AA from Standard and Poors.

### **Cash Management**

State funds are invested by the Treasurer and also by various state agencies, including the retirement systems and institutions of higher education. Permissible investments include those guaranteed by the United States of America, its agencies and instrumentalities (U.S. Government Obligations); repurchase agreements; corporate debt and equity obligations; and state and local government securities.

### **Risk Management**

The State manages risk with a combination of self-insurance and commercial policies. The State established the Risk Management Office in accordance with State law for the purpose of analyzing and making recommendations as to cost effective loss control and safety programs for the various State agencies.



The State also established the State Employees Insurance Advisory Committee (the Committee) by Act 48 of 1972 and allowed the Committee to pursue self-funding activities by Act 576 of 1975. The Committee provides comprehensive major medical care, prescription drug and life insurance for employees of the State and its participating component units, as well as their dependents, through the establishment of a variety of self-insured plans. The Committee also makes medical coverage available to retirees should they elect to continue such coverage at their own expense.

### **Audit**

The firm of Deloitte & Touche LLP performed the audit for the fiscal year ended June 30, 2001. Auditing standards generally accepted in the United States of America were used by the auditors in conducting the engagement. The auditors' report on the general purpose financial statements is included in the financial section of this report.

### **Awards**

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Arkansas for its Comprehensive Annual Financial Reports for the fiscal year ended June 30, 2000. This was the fifth consecutive year that the State has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized Comprehensive Annual Financial Report. The report must satisfy both accounting principles generally accepted in the United States of America and applicable legal requirements.

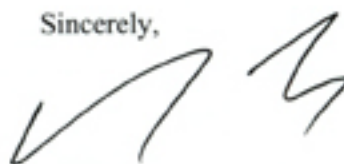
A Certificate of Achievement is valid for a period of one year only. We believe that our current report continues to conform to the Certificate of Achievement program requirements, and are submitting it to the GFOA to determine its eligibility for another certificate.

### **Acknowledgments**

Recognition for the leadership of accurate and timely financial reporting lies with Governor Mike Huckabee. He has made fiscal responsibility a high priority in his administration and his leadership has been crucial to the project's success. Governor Huckabee believes that this project will provide overall improvements in government accountability. It will save the State interest expense by providing market analysts, potential investors and others with complete, comparable financial information. It will provide the Legislature and others in key positions that require them to make financial decisions with clear, concise and complete financial data that is free of ambiguities or any misleading facts. The Governor's commitment to this project, especially his support of continued funding, demonstrates his firm belief in our continuing progress.

This report also would not be possible without the support of all state agencies that provided GAAP closing data on a timely basis. The future success of this project directly depends upon their continued cooperation and support as well.

Sincerely,



Dick Barclay  
Director